United States Department of Agriculture
FARM CREDIT ADMINISTRATION
Washington, D. C.

SUMMARY OF CASES RELATING TO FARMERS' COOPERATIVE ASSOCIATIONS

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For the

COOPERATIVE RESEARCH AND SERVICE DIVISION

Summary No. 30

June 1946

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Capital or Income

In the case of Appeal of Paducah & Illinois Railroad Company, 2 B.T.A. 1001, it appeared that certain railroad companies organized the Paducah & Illinois Railroad Company for the purpose of building and operating a bridge across the Ohio River for the use of the railroads concerned. Each railroad took a small amount of stock in the Paducah & Illinois Railroad Company, the bridge company, which company issued bonds in the amount of $5,000,000, out of the proceeds of which the bridge was constructed. These bonds were guaranteed by the railroad companies using the bridge and they were obligated to furnish money for their retirement.

In pursuance of agreements entered into by all of the companies involved, payments for the use of the bridge were made by the railroad companies using this facility and it was provided in effect that any amounts paid by any of the railroad companies over and above the share of each railroad company required for the maintenance of the bridge should be used for the retiring of the bonded indebtedness, whereupon preferred stock of the taxpayer was to be issued to the railroad company for the amount in question.

The taxpayer (bridge company) made returns of income to the collector of internal revenue for its district showing no net income and omitting from its returns $95,238 and $121,550 for the years 1920 and 1921 respectively, for which the taxpayer was obligated to issue preferred stock. The Commissioner of Internal Revenue took the position that the amounts just named were income to the taxpayer on which it was required to pay income taxes. The Board of Tax Appeals, now The Tax Court of the United States, stated that:

> "The issue is whether certain payments of $95,238 and $121,550, respectively, made to the taxpayers by certain other railroad companies constituted income or capital contributions during the years in question." (Underscoring added.)

In holding that the amounts under discussion were furnished as capital and not as income, the Board of Tax Appeals said in part:

> "In effect, the railroad companies agreed among themselves, as set forth in the above findings of fact, to construct the bridge over the Ohio River and to create for that purpose the taxpayer corporation, and to share the cost of that facility in the manner laid down in the agreements. Briefly, charges were to be made for the services rendered in amounts deemed sufficient to pay all of the expenses of the taxpayer and in addition to retire its indebtedness at maturity. In the first instance, bills were rendered monthly upon a traffic basis, but if the amounts collected under these bills were insufficient to meet the charges of the taxpayer, supplemental bills were rendered for each of the several months, making up the deficits and calling for contributions by the

railroad companies in the proportions of their original payments to the taxpayer. To the extent that the taxpayer's funds derived either under the original or the secondary bills were devoted to the retirement of bonds, the railroad companies were to receive preferred stock in the exact amount of their contributions used for that purpose. This was in accordance with the contract entered into July 1, 1915, by the two original participating railroad companies, and after September 1, 1920, participated in by the Illinois Central.

"From the beginning, the funds so contributed by the railroad companies were earmarked partly for the ordinary expenses of the taxpayer and partly for its capital requirements. In so far as the contributions were used or to be used for ordinary expenses, interest, taxes, and dividends, there can be no question that the railroad companies were making payments for services rendered by the taxpayer, which constituted expenses to themselves and income to the taxpayer. <u>To the extent, however, that their contributions were from the beginning required and, under the contract of July 1, 1915, were contemplated to be used for the retirement of debt and offset by preferred stock issued or to be issued to the railroad companies, the contributions were not expenses of the railroad companies, and were not income to the taxpayer. They were, on the one hand, investments of capital, and, on the other, receipts of capital for which stock was required to be issued.</u> A liability on account of bonds or for sinking fund payments was translated into a liability on account of preferred stock. So far as this taxpayer was concerned, there was no substantial change on its balance sheet, and this becomes instantly clear when it is realized that at no time did it have, under the procedure set forth in the contracts, any income which could be converted to surplus or utilized for the payment of dividends, except in so far as such contributions were required to pay dividends on preferred stock issued in conformity with the contract. Any surplus allocable to such a use would be, of course, income to the taxpayer, but no such surplus was actually created during the taxable years in question, so far as is indicated by any evidence now before the Board.

" * * * <u>From the beginning the funds so paid represented contributions by the railroad companies, for which they had an absolute right to the issuance to them of preferred stock.</u> We are also aware, as noted by the Commissioner in his brief, that no competent evidence was offered that preferred stock ever was actually issued to the railroad companies, and we have made no finding of fact with reference thereto. As we view the case, whether stock was actually issued at the time is immaterial. The railroad companies from the moment of their respective payments were entitled under their contracts to an accounting as to the disposition made of the funds so paid and to preferred stock in respect of their capital contributions. The stock was issuable on demand if not actually issued. Under these circumstances, the deficiency determined by the Commissioner must be disallowed." (Underscoring added.)

The contracts pursuant to which the railroad companies made payments to the bridge company did not specifically state that the amounts paid to the bridge company over and above amounts required for meeting operating costs and expenses were paid as capital, but the contracts positively obligated the bridge company to issue preferred stock for all amounts paid by the railroad companies which were used to reduce the bonded indebtedness of the bridge company. If the contracts in question had definitely specified that the excess amounts were furnished as capital, undoubtedly it would have been easier for the railroads to establish that such amounts were actually furnished as capital and hence were not income to the taxpayer.

In this case the railroads received preferred stock for amounts paid by them to the bridge company as rates, tolls, or charges in connection with services rendered. In other words any "excess" amounts paid to the bridge company over and above the share of any railroad company for the operating and maintenance expenses of the bridge company, as defined in the contracts, were evidenced by preferred stock. The bridge company was under a firm obligation to issue the preferred stock, and all amounts that the bridge company received that were required to be evidenced by preferred stock were held to be amounts that were received by the bridge company as capital and hence were not income from the standpoint of income taxes. In brief, the bridge company was capitalized, at least in part, through current operations and from amounts paid it as rates, tolls, or charges.

In the case of United Cooperatives, Inc. v. Commissioner of Internal Revenue, 4 T.C. 93, the cooperative was capitalized, at least in part, out of current operations and in pursuance of contractual obligations to account to its patrons for all amounts received by the cooperative over and above operating costs and expenses and amounts which the association was permitted to pay as dividends on stock. Under its bylaws the association was under a mandatory obligation to return this excess amount either in cash or stock. This case was decided by The Tax Court of the United States, formerly the Board of Tax Appeals, in September 1944, while the case involving the bridge company discussed above was decided by that tribunal in October 1925. In principle the cases are closely analogous.

In all instances in which capital is furnished to a corporation, cooperative or otherwise, whether by patronage or in any other way, it is believed that the amounts so furnished as capital out of current income technically constitute taxable income to the persons or patrons in question as of the tax year in which the capital is furnished, at least if the patrons are aware of the amount of capital that they have furnished. See "The Justifiability of the Policy of Exempting Farmers' Marketing and Purchasing Cooperative Organizations from Federal Income Taxes" by Randolph Paul, 29 Minn. L. Rev. 1.

That amounts furnished as capital by the patrons of a cooperative organization out of taxable income are taxable to the patrons furnishing such

capital, is apparently the position of the Bureau of Internal Revenue, as shown by a ruling of that Bureau appearing in Cumulative Bulletin 1938-2, page 127. This is such an important ruling that it is here given in full:

"Advice is requested relative to the treatment of 'deferred patronage dividends' of cooperative corporations organized and operating under chapter 390-G1 of the Code of Iowa, 1935.

"Under long established Bureau practice, amounts payable to patrons of cooperative corporations as so-called patronage dividends have been consistently excluded from the gross income of such corporations. The practice is based on the theory that such amounts in reality represent a reduction in cost to the patron of goods purchased by him through the corporation or an additional consideration due the patron for goods sold by him through the corporation. As such amounts are not includible in gross income of the corporation, they are obviously not deductible by it, though, where they have been erroneously included in gross income in the first instance, the correcting adjustment is sometimes loosely termed a deduction. Where patronage dividends are payable only to members or stockholders (or the members receive larger patronage dividends than nonmember patrons on identical transactions), the excess of the payments over the amounts due them on a patronage basis represents ordinary income to the corporation from business carried on by it for the joint profit of the members, and, consequently, distributions thereof to the members are essentially ordinary dividend payments.

"This office is of the opinion that there is a distinction between the patronage dividends here involved and the payments ordinarily termed 'patronage dividends.' However, like ordinary patronage dividends, those in the present case do not represent gross income of the corporation. If the so-called patronage dividends here in question have been erroneously included in gross income, their elimination therefrom is by way of exclusion rather than by way of 'deduction' in the correct sense of that word as used in the Revenue Acts. In view of the distinction between ordinary patronage dividends and those now under consideration, the question is presented as to the status of the instant 'dividends' for income tax purposes.

"In the State of Iowa, cooperative corporations organized and operated under the above-cited code are not authorized by the code to make 'patronage dividend payments' within the usual comprehension of that term. The code in section 8512-g30 provides that corporate earnings in excess of operating expenses (which include specified reserves, stated additions to surplus, permitted additions to an educational fund, and payment of fixed dividends on stock or memberships) shall be allocated to a revolving fund and shall be credited to the account of members in proportion to the business done with the association during the year. Such credits, which are referred to as 'deferred patronage dividends,' must be applied against unpaid or stock membership subscriptions, if any.

The directors are permitted by section 8512-g33 to use the revolving fund to pay debts, or add to the capital of the association, or retire its preferred stock. If so used, the deferred patronage dividend credits constitute a charge on the fund and on the corporate assets subordinate to creditors and preferred stockholders then or thereafter existing. The cited section also provides that deferred patronage dividends for any year shall have priority over those for any subsequent year. Section 8512-g34 provides that the association may issue transferable or nontransferable certificates for deferred patronage dividends. Section 8512-g35 provides that such dividend credits or certificates issued therefor shall not mature until the dissolution or liquidation of the association but shall be callable by it in the order of their issuance. Section 8512-g48 provides that on dissolution or liquidation the association shall first pay liquidation expenses, then its obligations other than patronage dividends, and the remaining assets shall be distriubted in the following order: (1) to preferred stockholders to the extent of their capital plus accrued dividends; (2) to holders of deferred patronage dividend credits or certificates issued therefor; (3) to members or common stockholders to the extent of their capital plus accrued dividends; and (4) the remaining assets to members in proportion to their deferred patronage dividend credits.

"A participation certificate issued by one of the corporations in question indicates that it has an established revolving fund credit on its books in the amount stated to the person named. It is stated on the certificate that such credits are noninterest bearing and payable at dissolution, but the association reserves the right to retire the certificate in whole or in part at any time. Such certificate further states that it represents capital contributed to the revolving fund from patronage dividends, that all money, property, and assets representing revolving fund credits need not be segregated or allocated, and that this certificate shall remain subject and inferior to the rights and claims of all creditors, common, secured, or preferred.

"It seems manifest <u>under the terms of the code in question that the amounts credited to the members as 'deferred patronage dividends' and allocated to the revolving fund represents contributions to the working capital of the corporation rather than an indebtedness of such corporation</u>. The members thus credited are entitled to receive the amount of such credit only at retirement, upon call by the corporation prior to liquidation, or upon liquidation if the assets of the corporation are sufficient to pay off such credits after paying off prior claims. Such credits do not mature during the life of the organization, do not bear interest, and are made subordinate to the claims of preferred stockholders. The holders of such credits divide accumulated earnings of the corporation after payment of preferred and common stock plus accrued dividends thereon. The holders are thus made a third class of shareholder in the corporation,

As the status of a shareholder in a corporation is not dependent upon the actual issuance of stock, the stated conclusion does not depend upon the issuance of participation certificates evidencing the credits in question.

"In view of the foregoing, it is apparent, in the opinion of this office, that patrons of the corporations in question are required by the terms of the code to take stock of the corporation in lieu of the usual patronage dividends. As such credits represent contributions for capital stock, the amount thereof is not income to the corporation but the value thereof is income to the patrons credited. That is, a patron member of one of the instant corporations agrees to buy or sell through the corporation with the understanding that in addition to the fixed consideration passing at the time of the transaction, his proportionate share of the proceeds of the corporation over its statutory operating expenses shall be credited to his capital account with the corporation.

"The above conclusion applies only to the extent that the credits involved represent earnings or receipts in excess of operating expenses on transactions with patron members. Under section 8512-g3 of the Iowa Code, 1935, the corporations may deal with nonmembers, but patronage dividend credits may be made only to members. Accordingly, to the extent such credits represent earnings or receipts in excess of operating expenses on transactions with nonmembers, the amount thereof is ordinary income to the corporation and the credits therefor to members should be treated as the issuance of stock dividends to members." (Underscoring added.)

It is true that the conclusion stated in the foregoing ruling, that the amounts involved were capital, is based largely, if not entirely, on the law of Iowa. In other words the conclusion reached was, in the opinion of the Bureau of Internal Revenue, demanded by the law of Iowa under which the cooperative corporations in question were incorporated. It should be kept in mind, however, that if contractual obligations, instead of code provisions, had required the handling of the money involved in precisely the same way, that there is every reason to believe that the same conclusion would have been reached.

Money must have the status of capital at the instant of receipt by a corporation if it is to be excludable or deductible in determining the income taxes of a nonexempt organization. It is believed that there is no way by which money received as income by a nonexempt organization may be converted thereafter into capital by such an organization so as to permit the amounts involved to be excludable or deductible in computing its income taxes. While amounts furnished as capital are not taxable as income in the hands of a corporation, they are taxable in the hands of the person furnishing the capital.

While amounts technically received as capital are not taxable as income in any case in the hands of a corporation, cooperative or otherwise, they

are taxable in the hands of the person furnishing the capital, assuming, of course, that the amounts furnished as capital were a part of his taxable income. In other words, if money is a part of the taxable income of a person, it does not cease to be taxable income because he has seen fit to furnish the money, regardless of the means employed for doing so, to a cooperative association for capital purposes. By prescribing through contracts with, or the bylaws of, a cooperative that a part of his current income is technically furnished by him for capital purposes, a member of a cooperative does not relieve himself from paying income taxes on the money involved. Of course if money furnished a cooperative for capital purposes is not a part of the taxable income of a member, no income taxes would be required to be paid thereon. For instance, money received as a gift (26 U.S.C. 22) is not money on which income taxes must be paid, and the fact that it was used by a member to capitalize a cooperative would not operate to change its income tax free status.

* * * * *

Robinson-Patman Act - Triple Damages

In the case of American Cooperative Serum Association v. Anchor Serum Company, 153 F.2d 907, it appeared that the American Cooperative Serum Association brought an action against the Anchor Serum Company, and also instituted a separate suit against the Illinois Farm Bureau Serum Association to recover triple damages for alleged violations of Section 2 of the Clayton Act, as amended by Section 1 of the Robinson-Patman Act, 15 U.S.C.A. Sec. 13(a), (c), (d), and (f).

> "Plaintiff is an Iowa Cooperative Association, organized for the purpose of manufacturing and selling to its own members biologics used in the prevention and treatment of hog cholera. It succeeded to the business of the American Serum Company, which assigned its business, good will, and a portion of the cause of action here involved, and ceased the manufacture and sale of serum.
>
> "The Anchor Serum Company, referred to as Anchor, is a Missouri corporation engaged in the manufacture and sale of serum. Defendant, Illinois Farm Bureau Serum Association, referred to as the Association, is a cooperative, incorporated under the Agricultural Cooperative Act of Illinois, 32 Ill.R.S. 1945, sec. 440 et seq. Its members are county farm bureaus or county or state farm organizations whose membership is limited to Farm Bureau members. Its purpose is the dissemination of information relative to diseases of live stock and preventive biologics to be used in the treatment of such diseases, and to act as agent for its members in collectively purchasing, handling and distributing such biologics and other supplies for its members.

"Its stock consists of 1000 shares Class A preferred; 2500 Class B preferred; and 1000 common shares. The first and last classes, in approximately equal amounts of each, are owned by its membership, which consists of about 100 Farm Bureaus, or farm organizations located in the 102 counties of Illinois. The Class B preferred was issued to and owned by the Illinois Agricultural Association, in whose offices in Chicago, Serum Association merely has desk room. The sole purpose of the Serum Association, as stated in its charter and bylaws and in its contracts with the County Farm Bureaus, is to act as purchasing agent for all the County Farm Bureaus in Illinois. The relationship between the Association and its members, the Farm Bureaus, is set forth in that membership agreement, which has been in force at all times herein referred to.

"That agreement recited that the Association was a state-wide organization formed to provide a central purchasing or manufacturing service for anti-hog cholera serum and virus and other biologics; that the member bureau was desirous of obtaining such central purchasing or manufacturing service and that the Association agreed to act as such purchasing agent; that the County Farm Bureau appointed and constituted the Association as its sole and exclusive agent to bargain for, purchase or manufacture and provide such quantities of serum as such member might require; that the member agreed that it would not purchase serum through or from any other person or persons while that contract remained in force and effect; that the member would buy only from the manufacturer selected by the Association, pay for such serum promptly, and maintain uniform retail prices for serum and other biologics or supplies with other members of the Association, such prices to be determined by the Association; and that in the event that serum was sold by the member to persons not members of a Farm Bureau, then the amount of business done with all of such non-members during any such fiscal year should not exceed in value the amount of business done with members during the same period.

"The production and distribution of this serum is regulated by the Federal Serum and Virus Act of 1913, 21 U.S.C.A. §§ 151-158; the Anti-Hog-Cholera Serum and Hog-Cholera Virus Act of 1935, 7 U.S.C.A. §§ 851-855; and the Marketing Agreement executed in December 1936, by and between handlers of serum, including Anchor, and the Secretary of Agriculture, pursuant to the last-named Act. This Agreement classified buyers of biologics as consumers, dealers, wholesalers, and volume contract purchasers, and provided for the appointment of a Control Agency to be composed of members of the industry to supervise operation of the Agreement. Plaintiff's president and Anchor's vice-president were original members of the Control Agency. The Agreement required each serum handler to file with the Secretary of Agriculture and the Agency a list of its selling prices to each class of buyers as defined by the Agreement and the Control Agency, including terms of sale and discounts, and it prohibited any sales unless such prices were so posted, and also prohibited any deviation from such posted prices. The Serum and Virus Act, 7 U.S.C.A. § 852,

provided that the making of such agreement should not be held in violation of any of the anti-trust laws. Anchor and plaintiff each signed the Agreement and filed a list of its selling prices in compliance therewith." (Underscoring added.)

Apparently the two cases were consolidated and on the trial in the District Court the jury found that the plaintiff had not been damaged by the defendants and hence was not entitled to recover damages. The plaintiff filed a motion to set the verdict aside and for a judgment notwithstanding the verdict. This motion was granted and judgment for plaintiff was entered by the District Court for triple damages in the sum of $17,666.10, plus an attorney's fee of $2,500, which was based "upon a finding by the court that plaintiff had been damaged as a proximate result of the matters complained of in the sum of $5,888.70." Defendants then appealed.

The case for the plaintiff was based on the ground that the defendant had injured the plaintiff by "unlawful acts in selling its competitive products at rates lower than those published by it, as required by law."

The defendant serum company had given excessive amounts to the Farm Bureau Serum Association for promotion work and for advertising allowances. These excessive amounts referred to by the court as "secret rebates" were considered as reducing the selling price of its serum to the Association below the posted prices named in the agreement filed with the Secretary of Agriculture pursuant to the Federal Serum and Virus Act and the Anti-Hog-Cholera Serum and Hog-Cholera Virus Act, and which agreement barred any deviation from such published prices. While the opinion of the court does not so state, it is assumed that buyers from the defendant serum company other than the Farm Bureau Serum Association did not receive allowances, or did not receive allowances comparable with those given to the association. Even if the Anchor Serum Company had given all its customers comparable allowances it may be that the court would have still regarded the deviation by that company from its posted prices as a violation of the Robinson-Patman Act. In other words, it is not clear that the court proceeded on the theory that under the unusual facts of this case that there must be discrimination by the Anchor Serum Company among its customers in order that the American Cooperative Serum Company would have a cause of action. Perhaps a deviation by the Anchor Serum Company from its posted prices was enough.

Under the terms of 15 U.S.C. 13 (f) it is unlawful if a person knowingly induces or receives a discrimination in price which is prohibited by that section, and apparently this was the basis for the case against the Farm Bureau Serum Association.

On appeal, the judgment of the trial court was in principle upheld, but the appellate court held that the actual damage sustained by plaintiff was $4,449.31, upon which a judgment should have been rendered for

$13,347.93. The following quotations from the opinion show the basis therefor:

"All orders for serum were made by the several Farm Bureaus for their respective members, and the shipments were made directly by Anchor to the Farm Bureau ordering them. They were charged, however, to the defendant Association which paid for them and collected the amount from the Farm Bureau which gave the order, and it in turn collected it from the Farm Bureau member to whom the serum was finally delivered. The Farm Bureaus who purchased serum from the Association, were rebated by the latter, by cash or credit, out of the funds received by it from Anchor, which in turn were passed on by the Bureaus to their respective members by credit on their serum accounts, or otherwise, in proportion to the amount of serum purchased and received by them.

"Anchor also had one wholesaler and several drugstore dealers to whom it sold its product in Illinois. The Association was the only volume contract purchaser with whom Anchor did any business before 1941. All serum thus sold by Anchor to the Association bore the label showing it to be processed and tested by Anchor and distributed by the Association, and gave the directions for its care and dosage. The Association had no refrigerating facilities for handling the serum from its own office.

"With respect to the allowances for advertising, promotional and educational work, Association's books disclose that it received from Anchor by rebate in the way of credits or checks the following amounts in the several periods set forth, together with the actual amounts expended by the Association for said purposes during the same periods:

	1937	1938	1-1-39 to 7-15-39
Rebate	$8,666.83	$39,044.30	$32,188.35
Expenditure..........	648.53	611.77	3,527.24

"It was plaintiff's theory, and the court sustained it, that the difference between the rebates and the actual expenditures for the purposes contemplated constituted unearned advertising and were allowances <u>which amounted to secret rebates from Anchor to the Association, which were discriminative and violative of the statute</u>.

"Plaintiff's only posted price was 75¢ for sales to consumers. This was done on December 16, 1936. Its charter only authorized it to manufacture for and sell serum to its own members. In making these sales it acted through druggists who acted as warehousemen who received the serum on consignment. Sometimes, however, the shipments were made to the druggists c.o.d. The druggists held the serum for sale to plaintiff's members, who became such, by signing an application for membership and paying 25¢ for membership dues.

These dues were not paid in cash but were deducted from the patronage dividends to which the purchasers became entitled as members. Blanks were furnished to the druggists, and when a farmer wished to purchase serum, he signed an application for it and also for membership, and left it with the druggist. The members received their share of a patronage dividend at the end of the appropriate fiscal year. This was the only method for plaintiff obtaining its members in Illinois, where it had 56 druggist-warehousemen in 1937, 49 in 1938, 46 in 1939, and 41 in 1940. By way of contrast defendants became the sellers of practically all serum in Illinois.

"In January 1937, plaintiff received complaints from its druggist-warehousemen to the effect that they could not sell plaintiff's serum at 75¢ to its consumers because the County Farm Bureaus who were members of Serum Association were selling the Anchor serum to consumers at 65¢. Thereupon, plaintiff instructed its warehousemen to reduce its consumer price in order to meet that competition. Plaintiff did not reduce its price throughout the state but only in those areas where it was necessary to meet the Farm Bureau competition in order to prevent the destruction of its Illinois business. In some places in Illinois it was able and did sell the serum at 75¢ because in those areas plaintiff's warehouseman was located where there was no Farm Bureau office or, if there were one, its sales organization was ineffective. A recovery is sought for the sales where plaintiff was compelled to sell its product, as it alleged and testified, at 65¢ instead of 75¢ by reason of the defendant's competition in violation of its marketing agreement.

"Defendants contend that the court erred in permitting plaintiff's witnesses to testify as to the reasons given to the plaintiff by their druggists why the latter could not sell plaintiff's serum at 75¢, which resulted in plaintiff's reduction in price. They urge that such evidence is hearsay, self-serving and thus incompetent. This was not error. Such evidence is an exception to the heresay rule and is well recognized. Lawlor v. Loewe, 235 U.S. 522, 35 S. Ct. 170, 59 L.Ed. 341; Wigmore on Evidence, 3d Ed., Vol. 6, sec. 1729; Greater New York Live Poultry Chamber of Commerce v. United States, 2 Cir., 47 F.2d 156; Kimm v. Steketee, 48 Mich. 322, 12 N.W. 177; Hubbard v. Allyn, 200 Mass. 166, 86 N.E. 356; Brannen v. Bouley, 272 Mass. 67, 172 N.E. 104.

"It is further contended that the evidence does not disclose that the defendants' price cutting was the cause of plaintiff's inability to sell its product. We can conceive of no fact which would more surely cause such inability than a cut in price by one's competitor. Here the parties stipulate that the serum produced by plaintiff and Anchor was of like grade and quality. Under these circumstances, coupled with the facts that the defendants did indirectly cut their prices, regardless of the Marketing Agreement, a prima facie case was made and plaintiff was not required in the first instance to prove the absence of all other conceivable causes. Under this

statute when a prima facie case is made, the burden shifts to the defendant, if it can do so, to show that the damage, if any, was otherwise caused. 15 U.S.C.A. § 13(b).

* * * * *

"In the facts before us, the rebates by Anchor to Serum Association were so greatly in excess of what the latter used for the purpose of advertising and promotion work that we feel compelled to agree with the District Court's holding that such rebates were merely for the purpose of reducing the purchase price to Serum Association and its members, which, in the absence of any other explanation, seems to be a clear violation of the statutes." (Underscoring added.)

There was a vigorous dissent in which the Judge among other things took the position that the plaintiff could not have been injured by the reduction in the sale price of serum from 75¢ to 65¢, because only members of the Farm Bureau were permitted to buy of the Farm Bureau organizations.

15 U.S.C. 15 reads as follows:

"Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. Oct. 15, 1914, c. 323, § 4, 38 Stat. 731."

This is the statutory provision under which the case under discussion was brought. Attention is called to the fact that this provision of law does not require that a violation of the antitrust laws shall have been aimed or directed against the person instituting a suit for treble damages. Indeed a cause of action would arise from unwittingly violating the antitrust laws. By the clear language of the provision, if a person or concern violates the antitrust laws and a person can show that such violation injured "his property or business" he is entitled to sue for treble damages. 15 U.S.C. 13 was made a part of the antitrust laws by the Robinson-Patman Act and this is the section which among other things prohibits discrimination in prices, services, or facilities by any person engaged in commerce. Of course any cooperative association, like any other business concern, may have proceedings instituted against it by the Federal Trade Commission, which proceedings may result in the issuance of a cease and desist order, which is simply an order to stop. A suit for treble damages, however, against a cooperative association or any other concern violating the antitrust laws may be instituted by any one who has been "injured in his business or property." Such a suit may have serious consequences.

For other cases arising under the Robinson-Patman Act see Summaries No. 2, page 1; No. 7, page 11; No. 11, page 13; No. 19, page 19; and No. 28, page 1.

Illegal Brokerage - Robinson-Patman Act

The cease and desist order issued by the Federal Trade Commission against the California Lima Bean Growers Association in a case arising under the Robinson-Patman Act involving the payment of brokerage to buyers upon purchases made by the buyers for their own account, follows:

"UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

"At a regular session of the Federal Trade Commission, held at its office in the City of Washington, D. C., on the 9th day of May, A. D. 1946.

"COMMISSIONERS:

William A. Ayres, Chairman
Garland S. Ferguson
Ewin L. Davis
Robert E. Freer
Lowell B. Mason

In the matter of CALIFORNIA LIMA BEAN GROWERS ASSOCIATION, a corporation.	DOCKET NO. 4939 ORDER TO CEASE AND DESIST

"This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission and the amended answer of the respondent, in which answer respondent admits all of the material allegations of fact set forth in the complaint and waives all intervening procedure, and the Commission having made its findings as to the facts and its conclusion that the respondent has violated the provisions of subsection (c) of Section 2 of the Act of Congress entitled 'An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes,' approved October 15, 1914 (the Clayton Act), as amended by the Robinson-Patman Act, approved June 19, 1936, (15 U.S.C., Sec. 13):

"IT IS ORDERED that the respondent California Lima Bean Growers Association, a corporation, and its officers, agents, representatives, and employees, directly or through any corporate or other device, in connection with the sale and distribution of lima

beans and other food products in commerce, as 'Commerce' is defined in the aforesaid Clayton Act, do forthwith cease and desist from:

"Paying or granting, directly or indirectly, to any buyer anything of value as a commission or brokerage, or any compensation, allowance, or discount in lieu thereof, upon purchases made for such buyer's own account.

"IT IS FURTHER ORDERED that the respondent shall, within sixty (60) days after service upon it of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which it has complied with this order.

"By the Commission.

"Otis B. Johnson,
Secretary."

* * * * *

Tender Unnecessary

In the case of Berrien County Fruit Exchange v. Pallis, et al., decided by the Supreme Court of Michigan, 22 N.W.2d 74, it appeared that the Exchange exercised its option, contained in a lease of which it was the assignee, to purchase a store building, and on refusal of the owner to transfer title to the property, brought suit for specific performance. The Exchange prevailed in the trial court and the Supreme Court of Michigan affirmed this decision.

Among other things the defendants contended that even though the Exchange had exercised the option to purchase, that the Exchange had failed to make a legal tender of the $6,500, the maximum purchase price specified in the option to purchase . The trial court found that "defendants cannot rely on such failure, because their pleadings and their evidence establishes that they denied plaintiff's right to tender and would have refused to convey even if sufficient tender had been made.", and the Supreme Court of Michigan said that it agreed with this finding.

It will be remembered that it is an established rule that a tender is unnecessary where from all the facts and circumstances it appears that the tender would have been rejected if made. The law abhors the doing of useless things, and if it appears that a tender would not have been accepted if made, this justifies the failure to make a tender. In 62 C.J. 657 it is said:

"A formal tender is unnecessary if the party to whom performance is due be absent from the place of performance, in those cases where

his presence is necessary; nor is a formal tender necessary if, at the time for performance, the party to whom performance is due fails or refuses to perform on his part, unless a request which he has no right to make is complied with, or if he is unable to perform, or does or suffers anything to be done with the thing to be delivered by him which renders certain a failure of performance on his part when the day arrives. Similarly, a tender is waived where the tenderee makes any declaration which amounts to a repudiation of the contract, or takes any position which would render a tender, so long as the position taken by him is maintained, a vain and idle ceremony; as where he expressly declares that he will not accept the tender if it is made, or has evaded tender, or in any other way obstructs or prevents a tender, as by declaring positively that nothing is due him, by admitting that a tender would be fruitless, by denying the existence of a binding contract, by declaring the contract to be at an end, or in a threatening tone ordering plaintiff off the premises. * * * "

* * * * *

Damages Recovered and Injunction Granted Against Interfering With Marketing Contract

In the case of Rinnander v. Denver Milk Producers, decided by the Supreme Court of Colorado, 166 P.2d 984, it appeared that the cooperative marketing association brought suit against the defendant for allegedly inducing or attempting to induce one John Wojtacha to breach his marketing contract with the association. The trial court enjoined the defendant and entered a judgment against him for $500 as liquidated damages, the amount provided for by the statute. The defendant then appealed the case to the Supreme Court of Colorado which affirmed the judgment of the trial court.

"The action was brought under section 41, chapter 106, '35 C.S.A., which reads, as follows: 'Any person or persons or any corporation whose officers * * * knowingly induce or attempt to induce any member or stockholder of an association organized hereunder * * * to break his marketing contract with the association * * * shall be guilty of a misdemeanor * * * and shall be liable to the association * * * in a civil suit in the penal sum of five hundred ($500) dollars for each such offense.'

"The facts are substantially as follows: John Wojtacha, his wife, son Alex, and two daughters, had been making their home on a 20-acre tract in the Arvada community, where they kept a dairy herd of about fifty head and sold milk. On May 8, 1942, two representatives of the association stopped at the farm and interviewed John Wojtacha about joining the association. There is dispute as to what was said

at the time, but he did sign a membership agreement. There is no suggestion that he was imposed upon, or that any misrepresentations were made to him regarding the contract, or that he did not sign it voluntarily. On August 26, 1942, the association sent John Wojtacha his membership card, a copy of the by-laws and articles of incorporation of the association, together with a letter telling him that he must sell his milk to one of a list of thirty dairies, one of which was the Wheatridge Dairy, and thereafter he did sell his milk to that dairy in accordance with his contract.

"Meanwhile, on July 30, 1942, the association sent to defendant by registered mail with request for return receipt, a letter in which was inclosed a list of the members of the association, one of whom was John Wojtacha. The letter contained the statement: 'We are sure you have no desire to interfere with the operation of this organization or to violate the Act under which the organization was incorporated and for that reason this information is given you hereto.' Quoted in the letter was section 28 of the 1923 Act ('35 C.S.A. c. 106, § 41, supra). Defendant admits the receipt of the letter and inclosures.

"About September 21, 1942, defendant, while out driving and looking for milk producers, called at the Wojtacha farm. He testified that he asked John Wojtacha if he was a member of the association and that John replied: 'They got my name, but I did not sign anything; I don't have anything to do with the milk. You will have to come back and see the boy.' The next day John was taken to the hospital. Also, on the 22d of September, defendant called on Alex, the son. Alex testified that defendant 'told me if we were dissatisfied where we were shipping, and I told him I did plan on changing shipping, * * * and—I asked Mr. Rinnander if he needed milk and he said yes, he did, so I started shipping to Mr. Rinnander.' Defendant admits offering Alex 2 cents a pound more for his milk than he was getting from the association. Alex admitted that defendant asked him if he or his father were in the association and admitted that he saw his father's membership card: Yet he testified: 'I told Mr. Rinnander that we weren't in the association.'

"Thereafter, two representatives of the association called on the father at the hospital for the purpose of showing him the contract. The father acknowledged that the signature thereon was his, and the representatives called on the son at the home, who admitted that it was his father's signature.

"October 3, 1942, the complaint was filed in this action.
October 28, 1942, the father executed a bill of sale to the son for the dairy herd, a part of which reads as follows: 'That this bill of sale is made in conformance with my verbal understanding made on September 10, 1942, that as of that date Alex J. Wojtacha should be from that time the owner of said cattle.' The note given in payment for the cattle remained in the possession of Alex, but the photostatic

copy shows endorsement of several payments thereon, in accordance with its terms. About the same time, a mortgage on the cattle of $1,500 to the Arvada bank was paid, but as to who made the payment the evidence is in conflict.

"The defendant testified that he did not know that John Wojtacha was a member of the association until he, defendant, was served with the summons in this case."

In affirming the judgment of the trail court the Supreme Court said in part:

"While defendant argues his specification of points under eight propositions, we think it necessary to consider only three of them: 1. Failure of the evidence to show that defendant acted 'knowingly.' 2. Failure of the evidence to show that defendant induced, or attempted to induce, a breach of the contract. 3. The transaction wherein defendant is charged with violating the statute was with a person who was not a member of the association, not bound by any contract, and who owned the cattle in his own right.

"1. To request us to hold that defendant did not act 'knowingly,' as that word is used in the statute involved, under the disclosed circumstances, would be unreasonable. Even assuming the truth of defendant's statement that he did not know that John Wojtacha was a member of the association until he received the summons in this case, his admissions disclose facts upon which it would be fair to say that he did know. His counsel seems to be of the opinion that because both the Wojtachas told him that they were not members of the association, there is no conflict in the evidence. He seems to disregard the documentary evidence which defendant admits receiving by registered mail. In addition, when John Wojtacha told Rinnander that the association had his name, Rinnander had actual knowledge of a fact that should have stopped him from further action. That there was at least a conflict in the evidence from which the trial court could properly reach its conclusion appears beyond question. Further, we think the argument of defendant's counsel that this is a penal statute and as such must be strictly construed, is not controlling. In the case of Fort v. Co-operative Farmer's Exchange, 81 Colo. 431, 256 P. 319, 322, it was contended 'that this section (chapter 106, section 41, supra) makes of the acts described a penal offense, a legal wrong, and that cannot be unless at least the act was accompanied by malice.' In response to that contention, we said in part: 'Whether or not such unlawful acts are criminal is not a question here. This is a civil, not a criminal, action (citing cases).' Further it will be noted that section 5, chapter 159, '35 C.S.A. provides: 'All general provisions, terms, phrases and expressions, used in any statute, shall be liberally construed, in order that the true intent and meaning of the general assembly may be fully carried out.' The intent of the General Assembly to protect these co-operative marketing associations against unlawful interference is so clear and

emphatic that there can be no doubt that this section 41, supra, was intended to cover just such situations as are disclosed by the facts in this case. 'The rule of strict construction is relaxed in the interpretation of an act designed to declare and enforce a principle of public policy, and a penal statute enacted for the benefit of the public generally should receive a fair and reasonable construction.' 59 C.J. 1119. See, also, 25 R.C.L. 1085, 1086. This principle is particularly applicable in the light of the declared legislative purpose as found in section 14, chapter 106, '35 C.S.A. If we were to adopt the subjective meaning of the word 'knowingly' it would be necessary to delve into the thoughts of a man and prove that he had actual knowledge, which would be placing an unreasonable restraint upon the enforcement of the act. We think the trial court was justified in its conclusion on the matter.

"2. Defendant admits that he offered Alex 2 cents a pound more for milk than he was receiving from defendant in error. This procedure is a favorite means of attack upon an association to induce a member to violate his covenant to deliver. Evans and Stokdyk, The Law of Co-operative Marketing, p. 133. Alex testified that immediately after receiving the offer of more money for milk, he began delivering to defendant's dairy. We think that under the disclosed circumstances the inducement to the son was equivalent to an inducement to the father. This appears from their statements on the witness stand, where both frequently used the pronoun 'we' in connection with their operation of their dairy, both before and after the attempted transfer.

"3. The argument of counsel for defendant that Alex was not a member of the association does not impress us as being sound. The trial court was fully justified in finding that the transfer of the dairy stock by the father to the son was a sham and not made in good faith. There was no change in possession as required by section 14, chapter 71, '35 C.S.A., and the situation is no different than that which obtained in Dairy Co-operative Association v. Brandes Creamery, 147 Or. 488, 30 P2d 338, 341, where the court in its opinion said: 'This is a case where an attempted evasion of a contractual duty by the formation of a new corporation, new (but not materially different) in name only, is interposed as a defense in equity where injunctive relief is sought against a continuing breach of said duty,' and refused to recognize the attempted transfer. As between father and son here, the General Assembly has taken away the rights of either to show that the father did not have control of the dairy herd. Paragraph (c), section 32, chapter 106, '35 C.S.A. Monte Vista Potato Grower's Ass'n. v. Bond, 80 Colo. 516, 252 P. 813. While this statute would not necessarily be controlling against defendant here, the court had a right to consider it in the relationship sought to be established by the Wojtachas."

In Liberty Warehouse Co. v. Burley Tobacco Growers' Co-op. Ass'n, 276 U.S. 71, the Supreme Court of the United States upheld a decision of the

Appellate Court of Kentucky in which the Burley Tobacco Growers' Cooperative Association recovered a penalty of $500 from a warehouse company that sold tobacco that was covered by a marketing contract of the association. In that case it appeared that "Before the sale the association notified the warehouse company of Kielman's membership and of his marketing contract, requested it not to sell his tobacco, and called attention to the prescribed penalties."

In an Arkansas case, Loewer v. Arkansas Rice Growers' Co-operative Association, 180 Ark. 484, 22 S.W. 2d 17, it was held that before an association could recover the statutory penalty from a person who had purchased commodities from one of its members that were covered by its marketing contract, that the association must show that the purchaser had actually induced the member to sell to them. In the case of Pacific Wool Growers v. Draper & Company, 158 Ore. 1, 73 P.2d 1391, the association failed in its attempt to enjoin the defendant from interfering with its marketing contracts, apparently on the ground that it had estopped itself from insisting on the right to prevent the defendant from buying of its members that were under contract with the association. In "Legal Phases of Cooperative Associations" on page 194 will be found a discussion of earlier cases in which marketing associations have recovered damages and have enjoined third persons from interfering with their marketing contracts.

In the Colorado case discussed above the trial court and the appellate court held that the attempt to transfer the title to the dairy herd was fictitious and hence ineffective. For other cases involving transfers in attempts to avoid contracts see "Legal Phases of Cooperative Associations," page 197.

* * * * *

Quo Warranto - Ousting Cooperative

In the case of State v. Sho-Me Power Co-op., decided by the Supreme Court of Missouri, 191 S.W. 2d 971, the State of Missouri, at the information of the prosecuting attorney of Wright County, Missouri, and at the relation of others, instituted quo warranto proceedings against this cooperative for the purpose of ousting the corporation. Certain public utility companies were permitted to intervene in the proceedings against the cooperative.

The Missouri Electric Power Company, identified in the opinion as M.E.P., owned and operated electric generating and distribution plants and transmission lines in 18 Missouri counties. The M.E.P. was owned by the Central Power and Electric Corporation, a Delaware corporation. That corporation was a subsidiary of the Central States Utilities Corporation, a Delaware corporation, which in turn was a subsidiary of Ogden Corporation,

another Delaware corporation, whose capital stock was owned by the Atlas Corporation. Under a plan of reorganization, which was filed with the Securities and Exchange Commission and later approved by that Commission and the United States District Court for the Eastern Division of the Northern District of Illinois, an order was made requiring the parent company to divest itself of the control of M.E.P. The Sho-Me Power Cooperative, Inc., purchased the property theretofore owned by M.E.P.

> "Sho-Me Power Cooperative Inc. (called Sho-Me), is a Missouri corporation organized and incorporated by certificate issued by the Secretary of State of Missouri on October 23, 1941, under Chapter 102, Article 28, Revised Statutes of Missouri for 1939, Mo.R.S.A. It was originally organized and incorporated with an authorized capital stock of $3,000, being 600 shares of the par value of $5, and with the declared purpose of operating electric utility service to its shareholders. Its place of business was designated to be Columbia, Missouri.
>
> "Sho-Me was incorporated by 26 persons who were members, active officers, and representatives of 26 electric cooperatives organized and operating in Missouri under the Federal Rural Electrification Act of Congress. Five other cooperatives subsequently joined, and at the time of the hearing in this case these representatives of 31 electric cooperatives and one individual, the secretary, constituted the membership of Sho-Me. Each of these members subscribed for one $5 share of stock and contributed $100.00 toward a development fund. Outside of these 32 shares no other shares of stock in Sho-Me have been issued.
>
> "Of the original incorporators of Sho-Me only four were operating in the general territory served by M.E.P. Two of those that subsequently became members of Sho-Me also operated in that territory.
>
> "The original intention of the incorporators of Sho-Me was to build generating plants if and when necessary. Afterwards when the M.E.P. purchase was proposed it was considered necessary and advisable to amend the articles of association."

The statute under which the Sho-Me Power Cooperative, Inc., was incorporated provided in Sec. 14406 as follows:

> "Any number of persons, not less than twelve (12), may associate themselves together as a co-operative association, society or exchange, having all the incidents, powers and privileges of corporations, for the purpose of conducting any agricultural or mercantile business on the co-operative plan, including the buying, selling, manufacturing, storage, transportation or other handling or dealing in or with by associations of agriculturists, of agricultural, dairy or similar products, and including the manufacturing transformation of such articles into products derived therefrom, and for the purpose of the purchasing of or selling to all shareholders

> and others groceries, provisions and all other articles of merchandise. For the purposes of this section the words 'association,' 'company,' 'corporation,' 'society' or 'exchange' shall be construed to mean the same."

The question for decision by the court was whether the cooperative statute under which the electric cooperative association had been incorporated provided for incorporation thereunder of an electric cooperative association. In holding that the statute did not so provide, the court said in part:

> "On one side, it is asserted that the mercantile business authorized by said section is limited to '(1) to dealing with or by associations of agriculturists, (2) to agricultural, dairy or similar products, (3) to manufacturing products derived from agricultural, dairy or similar products, and (4) to purchasing or selling groceries, provisions and all other articles of merchandise,' so that said act does not expressly or by implication authorize the incorporation of an electric utility company. Whereas, respondent contends that the enumeration following the word 'including' (where it appears the first time) does not limit or restrict its authority to engage in a mercantile business, but that, on the contrary, it is used as one of enlargement, and bears the meaning of 'also' or 'and'; and said section authorizes the formation of cooperatives 'to engage in either (1) any agricultural business; (2) or any mercantile business, or (3) a business for the purpose of purchasing or selling to all shareholders or others any article of merchandise.' It expressly disclaims being an association of agriculturists, or an agricultural cooperative, but contends that electricity is a commodity or article of merchandise, and hence in buying and selling electricity, or engaging in the 'electric business,' it is both conducting a mercantile business, and a business of buying and selling an article of merchandise, such as is expressly authorized by said statute.
>
> "It is a rule of statutory interpretation, hardly requiring citation of authority, that every word, phrase and sentence in a statute should be given some meaning, if possible. State v. Weatherby, 350 Mo. 741, 168 S.W.2d 1048; Norberg v. Montgomery, 351 Mo. 180, 173 S.W.2d 387. Proceeding then, to a determination of the effect to be given the enumeration following the word 'including,' either as a restriction upon, or enlargement of, the general language which precedes it, we find that the Supreme Court of the United States has said that in its ordinary sense 'including' is not a term of enlargement but such 'is its exceptional sense, as the dictionaries and cases indicate.' Montello Salt Co. v. People of State of Utah, 221 U.S. 452, 466, 31 S.Ct. 706, 709, 55 L.Ed. 810, Ann. Cas. 1912D, 633. The term has 'various shades of meaning, sometimes of restriction and sometimes of enlargement.' See 42 C.J.S., Include, pp. 525-527, and Cannon v. Nicholas, 80 F.2d 934, 935, 936, where the authorities are collated. It was pointed out in Phelps Dodge Corporation v. National Labor Board, 313 U.S. 177, 189, 61 S.Ct. 845, 85 L.Ed. 1271,

133 A.L.R. 1217, that the term is not one of all embracing definition, but may connote simply an illustrative application of a general principle, or preface an illustrative example of a general power already granted. Helvering v. Morgan's, Inc., 293 U.S. 121, 125, 55 S.Ct. 60, 79 L.Ed. 232. It has also been defined 'as having an accumulative sense and as classing that which follows with that which has gone before.' Maben v. Rosser, 24 Okl. 558, 593, 103 P. 674, 676. Was it so used in this instance?

"Here the statute authorizes the creation of cooperatives 'for the purpose of conducting any agricultural or mercantile business * * * including the buying, selling, manufacturing, storage, transportation or other handling or dealing in or with by associations of agriculturists, of agricultural, dairy or similar products.' We cannot escape the conclusion that the foregoing enumeration is rendered meaningless and useless if it was not intended to qualify and limit the scope of 'any agricultural or mercantile business,' because the latter words, standing alone, encompass the whole field, and if such was the legislative intent, it was unnecessary to say more. We think it is clear that the word 'including' was used restrictively in the sense of its synonyms 'comprising; comprehending; embracing,' and not as introducing elements constituting an enlargement of the purposes theretofore authorized. If we are correct in this conclusion, then it follows that respondent, not being an association of agriculturists (if for no other reason) is engaging in a business not authorized by the law under which it was organized.

"Moreover, we are of the opinion that an electric utility business is neither a mercantile business nor one 'for the purpose of the purchasing of or selling to all shareholders and others groceries, provisions and all other articles of merchandise' within the meaning of the statute. 'Companies engaged in the business of supplying electricity are commonly referred to as light and power companies. Such term is found in our legal digests. See Descriptive Word Index, American Digest System, and 33 Am.Jr. 1008. Light and power has become recognized as a generic term describing companies which furnish electricity.' Union Electric Co. v. City of St. Charles, 352 Mo. 1194, 181 S.W.2d 526, 528. We think if the Legislature had intended to authorize the creation of light and power cooperatives by the act in question it would have said so directly, and not through the use of language which requires the strained and unnatural construction that they are merchants. This view is fortified upon a consideration of the Rural Electric Cooperative Act, Laws 1939, p. 298, now Art. 7, Chap. 33, which expressly provides for the formation of cooperatives for the purpose of 'supplying electric energy and promoting and extending the use thereof in rural areas.'"

It was urged upon the court that the quo warranto proceedings were not prosecuted in the public interest. The court answered this contention by saying:

"But in this connection we are confronted with the constitutional provision, Art. XI, Sec. 5, Mo.R.S.A., that 'no corporation shall

engage in business other than that expressly authorized in its charter or by law * * *.' We think this question, too, is adequately treated by the report of the Special Commissioner wherein he says:

"'There is no element of estoppel in the present case, nor any question of laches. None was pleaded or proved. Each step respondent has taken toward the acquisition of the M.E.P. properties has been contested. Attempts were made to enjoin the consummation of the transaction pending a determination of the questions here involved. Respondent resisted the attempts to enjoin its purchase, and in its suggestions in opposition to the injunction stated:

"'"* * * And no injury can result from such a decree, because in rendering a judgment of ouster the court has the power to protect everyone concerned by making provision for a suitable period after which the order of ouster is to become effective, and to grant respondent an opportunity to reorganize and continue operating under authority of other statutes available to it for the purpose of reincorporation."

"'The purchase of the M.E.P. properties by Sho-Me was consummated after this proceeding in quo warranto was instituted and with full knowledge that this proceeding might result in a judgment of ouster against it. The respondent made provisions for just such a contingency. In the minutes of one of its meetings it appears that the attorney for respondent explained to the board of directors that some objections were being made to a closing of the purchase agreement until after final decision had been reached in pending litigation, including this proceeding. After explaining the reasons for the objections the attorney explained the proposed agreement which had been tentatively agreed upon, assuring the sellers of protection in the event of an adverse decision. * * *'"

It appeared that the board of directors of the cooperative had adopted a resolution which specifically recognized that quo warranto proceedings might be instituted against the cooperative, and in the resolution set forth conditions which were intended to protect the cooperative in the event that this contingency occurred. The financing required for the purchase of the properties in question was obtained from the Rural Electrification Administration.

"'As authorized by this resolution of the Board of Directors, the president and secretary of the respondent entered into an agreement, which provides, among other things, the following:

"'"Section 2. If, in the judgment of Sho-Me or the Administrator, Sho-Me's title to the System, or its right to own or operate the System, shall be found to be defective at any time within three (3) years after the closing date, or if it shall be finally determined by a court or commission of competent jurisdiction that Sho-Me is not a corporate entity or that Sho-Me lacks capacity to own or operate

the System, then Sho-Me with the approval of the Administrator, or the Government acting through the Administrator, shall designate a person or persons, or corporation or corporations, (such person or persons, or corporation or corporations, being hereinafter called the 'Nominee'), to take title to the System, and the Government shall (a) enter into a loan contract with and accept delivery of a note and of a mortgage or deed of trust from the Nominee, or (b) enter into an agreement with the Nominee, providing for the assumption by the Nominee of all of Sho-Me's obligations to the Government. Promptly upon designation of the Nominee as provided in this Section 2, any or all of the Sellers shall, at the request of Sho-Me or the Administrator execute and deliver to the Nominee a deed and bill of sale which shall have been executed and delivered, by MEP to Sho-Me on the closing date, and shall make, execute, acknowledge and deliver, or cause to be made, executed, acknowledged and delivered all such further instruments and conveyances, and shall take or cause to be taken all such further action as may reasonably be requested by Sho-Me, the Nominee or the Administrator to effectuate the intention of these presents. Thereafter, the Government shall release Sho-Me from any and all obligation to the Government arising out of any and all loans made to Sho-Me by the Government, acting through the Administrator."'

"In the light of these facts, said report recommends that respondent having 'acted in good faith on advice of counsel and under an opinion of the Attorney General of Missouri, and to prevent injury to the present consumers of electricity generated or distributed by respondent that the judgment of the court be so conditioned as to afford respondent a reasonable opportunity to effectuate the reorganization for which respondent has already made provisions.' Accordingly, the writ of ouster will issue, but respondent is granted the period of one year in which to effectuate its reorganization, if it is so advised, the court reserving jurisdiction of the case for such other and further action as may be deemed proper and appropriate in the premises."

This case illustrates that if an association is to engage in certain business activities, that it should be organized under a statute which clearly authorizes the incorporation thereunder of an association that may engage in such business activities.

Originally, all corporations in this country (excluding Federal corporations) were incorporated by special acts of the legislatures of the States concerned. No corporation could be organized in a State at that time unless its legislature was willing to enact a bill which specifically incorporated the corporation. On account of the favoritism which arose because of this manner of incorporating corporations, provisions were included in the constitutions of most if not all of the States providing that no private corporation could be incorporated by the enactment of a special statute (with certain exceptions in some instances) and authorizing the legislatures to enact general incorporation acts. In

most of the States if the incorporation statutes of that State do not provide authority for incorporating a private corporation to engage in a certain business, such a corporation may not be incorporated in that State. Sometimes close questions of interpretation arise relative to whether it is possible to legally form a corporation under a given statute.

In the case of State v. Hardin County Rural Electric Cooperative, decided by the Supreme Court of Iowa, 285 N.W. 219, an attempt was made by quo warranto proceedings to oust this cooperative on the ground that the statute under which it was incorporated did not authorize it to engage in the generation and distribution of electricity. The statute under which the association was incorporated authorized associations to be incorporated "To conduct a mercantile, manufacturing, mechanical or mining business, or to construct or operate telephone or electric transmission lines." The case turned, apparently, largely on the question of whether the generating of electricity was manufacturing. After reviewing a number of cases the court said:

> "While there are decisions that the generating of electricity is not manufacturing, the general rule is as stated in 26 Cyc. 522: 'The production of electricity by artificial means in a condition fit for use is generally held to be a manufacture, and the theory that it is merely the gathering of a gift of nature is disapproved.'"

In the case of State v. Wheat Farming Company, decided by the Supreme Court of Kansas, 22 P.2d 1093, the question was presented of whether corporations to engage in the raising of wheat for profit could be incorporated under an incorporation statute which provided for the formation of corporations to engage in "the encouragement of agriculture and horticulture." (Underscoring added.) It appeared from the opinion in this case that the administrative officers of the State, concerned with the formation of corporations, had for many years construed the phrase in question as authorizing the incorporation of corporations to engage in farming for profit. The corporations involved in this case were engaged in the raising of wheat on a large scale. Many points were argued before the Supreme Court of Kansas. The court, however, held that the words "the encouragement of agriculture and horticulture" did not authorize the formation of a corporation to engage in farming for profit.

In this connection the court said in part:

> "We conclude that the phrase 'encouragement of agriculture and horticulture' is composed of words of ordinary and approved usage, not technical in any sense; that it is not ambiguous, and therefore no resort should be had to any administrative construction that might have been placed upon it. The fact that members of the charter board may have misconceived the meaning of the phrase does not and cannot have the effect of making the statute mean something other than it plainly states, and as has heretofore been referred

to, the purpose stated in the charter was in the statutory language, and it must be assumed that every one concerned, the applicants as well as the members of the charter board, intended that a charter be granted only for lawful purposes and that the present activities of the corporation were not within contemplation, unless duly authorized by statute."

Judgment was rendered in favor of the State, but the court held that -

"these corporations should so arrange their affairs that within a reasonable period of time they will have disposed of all real estate and other property not necessary for use in the lawful exercise of the purpose for which they were created, and if it is impossible to so limit their respective activities, that they will liquidate their assets and dissolve their respective corporations. Jurisdiction of the cause is retained, and if steps are not taken by the respective corporations in line with the above suggestions, then, upon notice, the writ of ouster will issue and such further orders as may be necessary and expedient will be made."

In brief, the court held that the corporations must dispose of agricultural lands that they were using for the purpose of farming for profit.

A statute enacted by the State of North Dakota, Chapter 89, Laws of North Dakota for 1933, provides "That all corporations, both domestic and foreign, except as otherwise provided in this Act, are hereby prohibited from engaging in the business of farming or agriculture."

The statute, among other things, provided that all corporations, either domestic or foreign, who own any rural real estate "used or usable, for farming or agriculture, except such as is reasonably necessary in the conduct of their business, shall dispose of the same within ten years from the date that this Act takes effect..."

The statute was upheld in the case of Asbury Hospital v. Cass County, 72 N.D. 359, 7 N.W.2d 438.

The statute permitted corporations to own rural real estate and to engage in agriculture if they were "cooperative corporations, seventy-five per cent of whose members or stockholders are actual farmers, residing in (on) farms or depending principally on farming for their livelihood..." In upholding this exception to the prohibitory statute, the court said in part:

"The distinctions between general corporations and cooperatives have been held repeatedly to justify classification, and 'different treatment' as to each of such classes. United States v. Rock Royal Cooperative, 307 U.S. 533, 563, 59 S.Ct. 993, 83 L.Ed. 1446, 1464; Northern Wisconsin Co-op. Tobacco Pool v. Bekkedal, 182 Wis. 571, 197 N.W. 936, 945; Chafee v. Farmers' Co-Op. Elevator Company, 39 N.D. 585, 168 N.W. 616. See, also, Brown v. Steckler, supra;

Northwestern Mut. L. Ins. Company v. Wisconsin, 247 U.S. 132, 38 S.Ct. 444, 62 L.Ed. 1025; Orient Insurance Co. v. Daggs, 172 U.S. 557, 19 S.Ct. 281, 43 L.Ed. 552.

"The statute in question here authorizes cooperative corporations to acquire real estate and engage in cooperative farming or agriculture, and denies the power to so do to corporations organized under the general corporation laws. We are agreed that in so doing the legislature did not make such arbitrary or unreasonable discrimination as to constitute a denial of the equal protection of the laws or violate the requirement that all laws of a general nature shall have a uniform operation. In short, we believe there is a reasonable basis for the classification made."

Of course the State in which a corporation has been incorporated may always bring proceedings for the purpose of ousting the corporation or for restraining it from engaging in activities that are not authorized by its articles of incorporation. It is the general rule that third persons may not successfully raise the question that a corporation is exceeding its charter powers. See Bowles v. Inland Empire Dairy Association, 53 F. Supp. 210.

In some instances, however, in the Federal courts third persons have been permitted to successfully raise the question that a corporation is exceeding its powers. See United States v. American Live Stock Commission Co., 279 U.S. 435. In the case just cited a cooperative livestock association transacted business with nonmembers in violation of its charter and the Supreme Court of the United States held that the association could not successfully complain of a boycott by dealers in livestock insofar as the nonmember business was concerned.

It appears to be established that in any instance in which the officers and directors of a corporation, cooperative or otherwise, is exceeding the charter powers of the corporation, that any member or stockholder may bring an injunction proceeding for the purpose of restraining the officers and directors from exceeding such powers. See McCauley v. Arkansas Rice Growers Cooperative Association, 171 Ark. 1155, 287 S.W. 419; Galloway v. Mitchell County Electric Membership Corporation, 190 Ga. 428, 9 S.E.2d 903.

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When Is "Interest" Interest

In the opinion of the Supreme Court of the United States in the cases of The John Kelley Company v. Commissioner of Internal Revenue, and Talbot Mills v. Commissioner of Internal Revenue, 66 S.Ct. 299, it was held that payments made by the Kelley Company as interest were actually interest

and hence deductible as an operating expense in determining the income taxes of that company, but in the Talbot Mills case the court held that disbursements that had been made as interest were actually dividends and hence were not deductible in computing the income taxes of that corporation.

In the Kelley case The Tax Court of the United States, in 1 T.C. 457, held that the disbursements made by that company were interest, but this holding was reversed by the Circuit Court of Appeals in 146 F.2d 466. In the Talbot Mills case The Tax Court of the United States, 3 T.C. 95, held that the disbursements were dividends and this conclusion was affirmed in 146 F.2d 809, and the Supreme Court of the United States affirmed judgment of The Tax Court and the Circuit Court of Appeals in this case, but the Supreme Court reversed the Circuit Court of Appeals in the Kelley case, holding that the conclusion of The Tax Court was correct.

In the Kelley case it appeared that the corporation was reorganized by authorizing the issue of $250,000 of income debenture bearer bonds issued under a trust indenture calling for 8 percent noncumulative interest. These debentures were offered only to stockholders of the taxpayer but they were assignable and were payable in 20 years. The debenture holders had priority of payment over stockholders but were junior to all other creditors.

In the Talbot Mills case it appeared that all of the stock of the corporation in question, with the exception of some qualifying shares, were held by members through blood or marriage of the Talbot family. In an effort to adjust the capital structure the company was recapitalized by each stockholder surrendering four-fifths of his stock and taking in lieu thereof registered notes in aggregate face value equal to the aggregate par value of the stock retired. The notes were dated October 2, 1939, and were payable December 1, 1964. The notes bore interest at a rate not to exceed 10 percent nor less than 2 percent, subject to a computation that took into consideration the net earnings of the corporation for the fiscal year ended last previous to the annual interest paying date. The notes were transferable only by the owner's endorsement and the notation of the transfer by the company. The interest was cumulative and payment might be deferred until the note's maturity, when necessary by reason of the condition of the corporation. The Supreme Court said in part:

> "In the Kelley case there were sales of the debentures as well as exchanges of preferred stock for debentures, a promise to pay a certain annual amount, if earned, a priority for the debentures over common stock, the debentures were assignable without regard to any transfer of stock, and a definite maturity date in the reasonable future. These indicia of indebtedness support the Tax Court conclusion that the annual payments were interest on indebtedness. On the other hand, in the Talbot Mills case, the Tax Court found the factors there present of fluctuating annual payments with a two per cent minimum, the limitation of the issue of notes to

stockholders in exchange only for stock, to be characteristics which distinguish the Talbot Mills notes from the Kelley Company debentures. Upon an appraisal of all the facts, the Tax Court reached the conclusion that the annual payments by Talbot Mills were in reality dividends and not interest."

Apparently the Supreme Court was of the opinion that in matters of this kind great weight should be given to the conclusions of The Tax Court and that the conclusions of that Court should not be lightly set aside. In this connection the court said:

"These cases now under consideration deal with well understood words as used in the tax statutes - 'interest' and 'dividends.' They need no further definition. Equitable Life Assurance Society v. Commissioner, 321 U.S. 560; Deputy v. DuPont, 308 U.S. 488, 498. The Tax Court is fitted to decide whether the annual payments under these corporate obligations are to be classified as interest or dividends. The Tax Court decisions merely declare that the undisputed facts do or do not bring the payments under the definition of interest or dividends. The documents under consideration embody elements of obligations and elements of stock. There is no one characteristic, not even exclusion from management, which can be said to be decisive in the determination of whether the obligations are risk investments in the corporations or debts. So called stock certificates may be authorized by corporations which are really debts and promises to pay may be executed which have incidents of stock. Such situations seem to us to fall within the Dobson rule.

"This leads us to affirm the Talbot Mills decree and to reverse the Kelley judgment."

For other cases bearing on the subject under discussion, see "Creditor or Stockholder - Interest or Dividends," Summary No. 26, p. 10.